In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 678

JAMES G. NASH AND CECELIA NASH, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

During 1961, petitioners were members of a partnership operating eight finance organizations in Alabama and two in South Carolina. The partnership reported its income on the accrual method of accounting and used the reserve method of accounting for bad debts permitted by Section 166(c) of the Internal Revenue Code and Treasury Regulations, Section 1.166-4.

Under this method, a taxpayer maintains a reserve account, the balance of which is to be adjusted at the end of each year, so that it equals that portion of current accounts receivable that is reasonably estimated to become worthless in subsequent years. Any additions necessary to increase the reserve to its required

367-274—69

level are currently deductible. When accounts receivable become worthless during the year, the reserve account is decreased and no additional deduction is allowed. As of May 31, 1960, petitioners' partnership books reflected accounts receivable for the Alabama organizations of $486,853.69 and a reserve for bad debts of $73,028.05 (Pet. App. B 15–16).

On June 1, 1960, petitioners formed eight new corporations and transferred the assets of the eight Alabama organizations, including the accounts receivable, to these corporations in exchange for the latters' stock. The transfer was within the terms of Section 351 of the Internal Revenue Code, which provides that no gain or loss shall be recognized on transfers of property to a corporation in exchange for stock, if, immediately after the exchange, the transferors possess at least 80 percent control of the corporation.

The issue here is whether the balance remaining in petitioners' reserve for bad debts account, which had been deducted from prior years' income, but which represented petitioners' estimate of current accounts receivable that would become worthless in subsequent years, should be restored to income in the year of the transfer of the partnership assets, because the need for the reserve terminated upon the transfer.

The district court held that the amount of the outstanding reserve for bad debts did not have to be restored to petitioners' income for the year of the transfer (Pet. App. B, pp. 15–21). On the Government's appeal, the Fifth Circuit reversed (Pet. App. A, pp. 10–14). The Ninth Circuit considered the iden-

tical question in ***Estate of Schmidt*** **v.** ***Commissioner,*** 355 F. 2d 111, and held to the contrary, *i.e.*, that the bad debt reserve of a proprietorship did not have to be restored to income in the year of a Section 351 transfer of all of its assets to a corporation.

Because the incorporation of a proprietorship or partnership is a commonplace transaction, the question presented is a recurring one in the administration of the Code.[1] In view of the conflict between the courts of appeals, it is unlikely that a settled rule will be established except through review by this Court. Accordingly, respondent does not object to the granting of the petition.

Respectfully submitted,

ERWIN N. GRISWOLD,
Solicitor General.

OCTOBER, 1969.

---

[1] The Internal Revenue Service has advised that the cases listed by petitioners (Pet. 5) all present the issue involved in the instant case. Taxpayers in *Schuster* v. *Commissioner*, 50 T.C. 98, however, have dismissed their appeal to the Second Circuit. The Commissioner's position has again been recently sustained by the Tax Court in *Hutton* v. *Commissioner*, 53 T.C. No. 6 (decided October 13, 1969). *Scofield* v. *United States* (Pet. 5), decided adversely to the Government in the United States District Court for the Central District of California March 3, 1969 (69–1 U.S.T.C., par. 9386), is presently pending in the Ninth Circuit on appeal.

U.S. GOVERNMENT PRINTING OFFICE: 1969